

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:LM:CTM:SD:POSTF-117940-02  
GLGidlund

date: June 11, 2002

to: David Simmons, Revenue Agent, Team 1756  
San Diego

from: Associate Area Counsel (LMSB: CTM)  
San Diego

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subject: Request for Assistance

Taxpayer: [REDACTED], Inc.

EIN: [REDACTED]

Tax Year: [REDACTED]

*This memorandum responds to your request for assistance in this case. This memorandum should not be cited as precedent.*

**ISSUES:**

1. Whether the claimed deduction for certain amounts paid to former directors and officers is limited under I.R.C. § 162(m)?
2. Whether the claimed deduction for certain amounts paid to former directors and officers is limited under I.R.C. § 280G?

**CONCLUSIONS:**

1. (b)(5)(AC), (b)(7)a  
[REDACTED]

2. (b)(7)a  
[REDACTED]

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**FACTS:**

*Our advice is contingent on the accuracy of the information that the Internal Revenue Service has supplied. If any information is uncovered that is inconsistent with the facts recited in this memorandum, you should not rely on this memorandum, and you should seek further advice from this office.*

[REDACTED], Inc. (Taxpayer) operates a chain of "[REDACTED]" or "[REDACTED]" stores in [REDACTED] states that specialize in selling [REDACTED] and [REDACTED] related merchandise, typically to [REDACTED] with a [REDACTED]. Its stores average [REDACTED] square feet and are located primarily in [REDACTED].

(b)(7)a



We assume that for purposes of this opinion that no part of the payments made to [REDACTED] constitute payments as described in section 3121(a)(5)(A) through (D). See, e.g., Treas. Reg. § 1.162-27(c)(3)(ii)(A).

**ANALYSIS:****Section 162(m):**

Under section 162(a)(1), a taxpayer may deduct all of the ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal

services actually rendered. But in the case of a publicly held corporation, section 162(m)(1) operates to limit the deduction for applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year exceeds \$1,000,000. Treasury Regulation section 1.162-27(c)(2) defines a "covered employee" as any individual who, on the last day of the tax year, is (A) the chief executive officer of the corporation or is acting in such capacity; or (B) among the four highest compensated officers (other than the chief executive officer). Whether an individual is the chief executive officer or one of the four highest compensated officers is determined pursuant to the executive compensation disclosure rules under the Securities Exchange Act of 1934. (We assume that all in the [REDACTED] [REDACTED] fall into one or the other category.) In the notice of proposed rulemaking containing the proposed regulations under section 162(m), the preamble contains the following language concerning the identification of "covered employee":

The regulations clarify which employees are "covered employees" for purposes of section 162(m). The legislative history to section 162(m) provides that "covered employees" are defined by reference to the SEC rules governing executive compensation disclosure under the Exchange Act. Under the regulations, an individual generally is a "covered employee" if the individual's compensation is reported on the "summary compensation table" under the SEC's executive compensation disclosure rules, as set forth in Item 402 of Regulations S-K, 17 C.F.R. 229.402, under the Exchange Act. However, the regulations specifically provide that, in order to be a "covered employee" for section 162(m) purposes, an individual must be employed as an executive officer on the last day of the taxable year. Thus, only those employees who appear on the "summary compensation table" and who are also employed on the last day of the taxable year are "covered employees."

(Emphasis added.)

(b)(7)a

(b)(7)a, (b)(5)(AC)

(b)(7)a, (b)(5)(AC)

(b)(5)(AC)

Typically, severance payments are deductible. See Rev. Rul. 94-77, 1994-2 C.B. 19.

(b)(7)a, (b)(5)(AC)

On January 24, 2002, an advance notice of proposed rulemaking (ANPRM) was issued stating the expectation of the Service and Treasury to propose a rule requiring capitalization of certain transaction costs that facilitate the acquisition, creation, or enhancement of certain intangible assets or benefits. In a memorandum from LMSB Commissioner Larry R. Langdon dated April 26, 2002, it was stated that this rule would not require capitalization for employee compensation, except bonuses and commissions over \$5,000, and thus examiners should not be proposing capitalization in such instances.

(b)(5)(AC), (b)(7)a

#### Section 280G:

Section 280G provides that no deduction will be allowed for any excess parachute payment. Section 280G(b)(1) defines "excess parachute payment" as an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment. Section 280G(b)(2)(A) defines "parachute payment" as any payment in the nature of compensation to (or for the benefit of) a disqualified individual if (i) such payment is contingent on a change in the ownership or effective control of the corporation or in the ownership of a substantial portion of the assets of the corporation and (ii) the aggregate present value of the payments in the nature of compensation to (or for the benefit of) such individual that are contingent on such change equals or exceeds an amount equal to three times the base amount. Section 280G(d)(1)(A) defines the "base amount" as the average annual compensation income payable to an individual by the corporation which had a change in ownership or control and was includible in the gross income of that individual for the tax years in the base period.

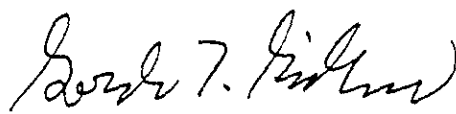
Section 280G(d)(2) defines the "base period" as the time period consisting of the five most recent tax years that ended before the date on which the change in ownership or control occurred.

(b)(5)(AC), (b)(7)a

If you have any questions, please call me at (619) 557-6014.

*This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.*

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